We expect to see more sectors participate in the market’s performance in 2021 – beyond the mega-cap tech stocks that outperformed during the early days of the pandemic. Abundant central-bank liquidity should also create new opportunities within fixed-income markets, and institutional investors may want to tap the private markets to finance the recovery of the real economy. Visit allianzgi.com for our full 2021 outlook.

**Equities**

The wide adoption of promising Covid-19 vaccines could benefit a range of regions and sectors – beyond the mega-cap US tech firms that have already done well. Likewise, a further deterioration on the Covid front is likely to put pressure on the direction of equity prices. So far, the growth outlook remains unclear and private-sector spending could be suppressed, which will place a greater burden on governments and central banks to provide stimulus. If virus-related fears about economic growth intensify, we expect that the financial markets will expect more stimulus – and begin to price it in.

Yet even now, central banks around the world are continuing to pump liquidity into their economies and trying to encourage investors to move out of “safe” assets and into riskier ones. This has stretched some equity valuations. For example, US equities not only constitute more than 50% of the global equity market in terms of market value, but also appear pricey when judged by most valuation metrics (including price-to-earnings ratios). However, we expect broader participation in the market’s performance in 2021:

- As Exhibit 1 shows, some undervalued regions outside of the US could do well, particularly if we see a global rebound in growth. Look to Europe and emerging markets for potential value cyclical opportunities.
- Consider North Asia and China for secular growth themes, such as China’s investment in new infrastructure and the overall shift towards digitalisation in Asia – including e-commerce, 5G and artificial intelligence.
- The outlook for emerging-market equities is diverse. For example, Poland and Mexico seem to have strong near-term prospects while Russia and Brazil are struggling – though they could be set to rebound when capital begins flowing back in.

**Exhibit 1: equities in the US are expensive compared with Europe and Japan**

Cyclically adjusted price/earnings ratios (1980-2020)

The value style of investing has underperformed and recently sold at a deep discount compared to its growth counterparts, so value cyclicals (including select industrials and financials) could benefit from the global economy’s continued re-opening.

Under a Biden administration, clean energy sources – such as wind and solar – would likely benefit from increased investment and favourable tax and regulatory policies. Mr Biden has also indicated his support for investing in traditional infrastructure – such as the rebuilding of roads, bridges and airports – as well as technology infrastructure such as 5G and artificial intelligence.

**Fixed income**

We believe there are attractive opportunities within the fixed-income markets, despite weak macroeconomic fundamentals. Abundant central-bank liquidity continues to provide a favourable backdrop for fixed-income securities in general, and particularly risk assets. As global economic growth recovers, we favour a reflation theme. This may take the form of US “curve steepener” trades (favouring short-term over long-term Treasuries; see Exhibit 2) and allocating risk to spread products (including emerging-market debt, investment-grade corporate bonds and high-yield debt). Another argument in favour of these areas is that central banks – which are price-insensitive buyers of bonds – participate in some of these markets. We are fully aware of the fact that leverage in the corporate sector has significantly increased during this recession. With the US dollar potentially set to fall in value, investors may want to consider underweighting the currency.

The speed and scale of the monetary and fiscal policy measures related to the pandemic have helped reduce the depth and longevity of the global recession, and the global economy has started to recover. But as governments in the developed world continue to provide large-scale stimulus to support their economies, there has been a significant deterioration in government-debt metrics. We believe this means central-bank policy will be generous for the foreseeable future, just as we saw after the 2008-2009 financial crisis. Policy makers want to keep interest rates low to support the recovery; they don’t want to raise rates and risk triggering defaults. Expect to see continued monetary accommodation – including quantitative easing and interest rates that hover near zero (or even move into negative territory) – as policymakers navigate the new macroeconomic landscape.

**Exhibit 2: the US yield curve has started to steepen**

*5-year/30-year Treasury spread (2010-2020)*

Private markets

Private markets have enjoyed significant growth in recent decades (see Exhibit 3), in large part because of their ability to provide institutional investors with the potential for excess returns and alternative revenue sources that are largely uncorrelated to public markets. Market dynamics have also been favourable to this asset class. Growing regulatory challenges have put pressure on banks, creating an opportunity for institutional investors to provide capital, and in recent years there has been increased activity from corporations ready to put these funds to work. With growth in average deal values, more companies can rely on funding from investors and stay private for longer.

From the outset, the Covid-19 pandemic quickly created stress and uncertainty in markets around the world. As economic activity slowed, many businesses were forced to react to the situation by cutting costs and capital expenditures, and by drawing on credit lines. Governments responded by committing vast sums for emergency financing while banks mainly concentrated on key relationships and core sectors. However, with bank and credit insurer activity expected to tighten, we foresee a growing demand for credit from mid-market corporations and non-core infrastructure sectors – as well as a greater demand for trade finance across all sectors of the economy. Institutional investors can benefit from this development and capture opportunities through private-market investments – and in turn help finance the recovery of the real economy.

Asia is one example of the opportunity available to private-market investors. In a world where growth is in short supply, Asia has a bright outlook for growth thanks to its rising middle class, increasing consumption, strong productivity and rapid pace of digitisation. Moreover, most Asian governments have responded to the Covid-19 crisis by boosting fiscal and infrastructure spending – further fuelling many of these trends. Middle-market companies in Asia stand to be among the primary beneficiaries of these growth drivers, yet many of these firms lack credit. Investors have an opportunity to provide funding to these companies through the private credit markets. This gives investors access to attractive risk-adjusted return potential, proprietary cash flows, and limited correlation to broader fixed-income and equity markets through real assets – as opposed to financial assets.

It is true that globally, some sectors have struggled during this crisis – particularly airports, retail and construction. Yet others that provide essential services to the public have seen a very limited impact on demand (including telecom towers, pharmaceuticals, regulated utilities and data centres) or are expected to experience a sharp rebound (such as healthcare, transport, education and business software) as economies recover. Across multiple sectors, private markets have demonstrated their resilience and ability to add value in an institutional portfolio context – including exhibiting rating volatility that has generally been far lower than the public markets have experienced.

The pace of deal activity seems to have regained steam after a slowdown in the first half of 2020. With governments launching new stimulus packages to help support their economies, institutional investors can play a vital role in the post-pandemic recovery. Given the macro environment, we expect a larger set of investment opportunities to emerge while valuation expectations and credit terms return to more reasonable levels.
Allianz Global Investors is a leading active asset manager with over 750 investment professionals in 25 locations worldwide and managing EUR 546 billion in assets for individuals, families and institutions.

Active is the most important word in our vocabulary. Active is how we create and share value with clients. We believe in solving, not selling, and in adding value beyond pure economic gain. We invest for the long term, employing our innovative investment expertise and global resources. Our goal is to ensure a superior experience for our clients, wherever they are based and whatever their investment needs.

Active is: Allianz Global Investors

Data as at 30 September 2020

The MSCI Europe Index is an unmanaged index that measures the performance of the equity market of the developed markets in Europe. The MSCI Japan Index is an unmanaged index that measures the performance of the equity market of Japan. The Standard & Poor's 500 Composite Index (S&P 500) is an unmanaged index that is generally representative of the US stock market. Investors cannot invest directly in an index.

Investing involves risk: The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Equities have tended to be volatile, and do not offer a fixed rate of return. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bond prices will normally decline as interest rates rise. The impact may be greater with longer-duration bonds. Credit risk reflects the issuer’s ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. Emerging markets may be more volatile, less liquid, less transparent, and subject to less oversight, and values may fluctuate with currency exchange rates. Investments in alternative assets presents the opportunity for significant losses including losses which exceed the initial amount invested. Some investments in alternative assets have experienced periods of extreme volatility and in general, are not suitable for all investors. Environmental, Social and Governance (ESG) strategies consider factors beyond traditional financial information to select securities or eliminate exposure which could result in relative investment performance deviating from other strategies or broad market benchmarks. Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This document does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security.

The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

This material has not been reviewed by any regulatory authorities. In mainland China, it is used only as supporting material to the offshore investment products offered by commercial banks under the Qualified Domestic Institutional Investors scheme pursuant to applicable rules and regulations. This document does not constitute a public offer by virtue of Act Number 26.831 of the Argentine Republic and General Resolution No. 622/2013 of the NSC. This communication’s sole purpose is to inform and does not under any circumstance constitute promotion or publicity of Allianz Global Investors products and/or services in Colombia or to Colombian residents pursuant to part 4 of Decree 2555 of 2010. This communication does not in any way aim to directly or indirectly initiate the purchase of a product or the provision of a service offered by Allianz Global Investors. Via reception of his document, each resident in Colombia acknowledges and accepts to have contacted Allianz Global Investors via their own initiative and that the communication under no circumstances does not arise from any promotional or marketing activities carried out by Allianz Global Investors. Colombian residents accept that accessing any type of social network page of Allianz Global Investors is done under their own responsibility and initiative and are aware that they may access specific information on the products and services of Allianz Global Investors. This communication is strictly private and confidential and may not be reproduced. This communication does not constitute a public offer of securities in Colombia pursuant to the public offer regulation set forth in Decree 2555 of 2010. This communication and the information provided herein should not be considered a solicitation or an offer by Allianz Global Investors or its affiliates to provide any financial products in Brazil, Panama, Peru, and Uruguay. In Australia, this material is presented by Allianz Global Investors Asia Pacific Limited ("AllianzGI AP") and is intended for the use of investment consultants and other institutional/professional investors only, and is not directed to the public or individual retail investors. AllianzGI AP is not licensed to provide financial services to retail clients in Australia. AllianzGI AP (Australian Registered Body Number 160 464 200) is exempt from the requirement to hold an Australian Foreign Financial Service License under the Corporations Act 2001 (Cth) pursuant to ASIC Class Order (CO 03/1103) with respect to the provision of financial services to wholesale clients only. AllianzGI AP is licensed and regulated by Hong Kong Securities and Futures Commission under Hong Kong laws, which differ from Australian laws.

This document is being distributed by the following Allianz Global Investors companies: Allianz Global Investors U.S. LLC, an investment adviser registered with the U.S. Securities and Exchange Commission; Allianz Global Investors Distributors LLC, distributor registered with FINRA, is affiliated with Allianz Global Investors U.S. LLC; Allianz Global Investors GmbH, an investment company in Germany, authorized by the German Bundesanstalt für Finanzdienstleistungsauflsicht (BaFin). Allianz Global Investors (Switzerland) AG, Allianz Global Investors Asia Pacific Ltd., licensed by the Hong Kong Securities and Futures Commission, Allianz Global Investors Singapore Ltd., regulated by the Monetary Authority of Singapore [Company Registration No. 199907169Z], Allianz Global Investors Japan Co., Ltd., registered in Japan as a Financial Instruments Business Operator [Registered No. The Director of the Kanto Local Finance Bureau (Financial Instruments Business Operator), No. 424, Member of Japan Investment Advisers Association and Investment Trust Association, Japan]; and Allianz Global Investors Taiwan Ltd., licensed by Financial Supervisory Commission in Taiwan.

© 2020 Allianz Global Investors.